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Supreme Court of the United States

OCTOBER TERM 1946

No. 791...

IN PROCEEDINGS FOR THE REORGANIZATION OF A RAILROAD.

IN THE MATTER

of

THE CHICAGO, ROCK ISLAND AND PACIFIC RAILWAY COMPANY,
Debtor,

GERALD AXELROD, *et al.*, constituting a Group of Individual Owners of the 4½% Convertible Gold Bonds of the above-named Debtor, dated May 1, 1930,
Petitioners,

v.

JOSEPH B. FLEMING and AARON COLNON, as Trustees of The Chicago, Rock Island and Pacific Railway Company, *et al.*,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

TO THE HONORABLE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioners, a group of nineteen (19) individual holders and owners of the 4½% Convertible Gold Bonds

issued by the above named Debtor on May 1, 1930 to become due May 1, 1960, respectfully pray that a writ of certiorari issue to review the order and interlocutory decree of the United States Circuit Court of Appeals for the Seventh Circuit which was entered in the above cause on May 23, 1946 modified June 20, 1946, and which affirmed an order of the United States District Court for the Northern District of Illinois, Eastern Division, entered June 15, 1945 approving a plan of reorganization of the Debtor.

In this petition, your petitioners rely upon the Transcript of Record filed by the Debtor in this Court, October Term—1946, No. 410, and all references to the Transcript of Record ("R") are to that record. Additional Transcript of Record filed by these petitioners is referred to as "Add R".

This petition is also related to the petition for writ of certiorari filed in this Court by the Trustees for the Debtor where certain respondent creditors (*i. e.* Choctaw & Memphis bonds) are allowed interest upon interest by the same Circuit Court on their claims in cash. (October Term—1946, No. 454). This Court is opposed to permitting such a claim to share in the assets of an insolvent debtor. (*Vanston Bondholders Protective Committee* v. *Green,* U. S. Sup. Ct. Bulletin, p. 255, per Black, J., Dec. 9, 1946.)

Opinions Below

The opinion of the United States District Court for the Northern District of Illinois, Eastern Division (R. 301-308) was filed on May 14, 1945; it has not been reported. The opinion of the Circuit Court of Appeals for the Seventh Circuit (R. 343-355) was filed on May 23, 1946 and is reported in 157 F. (2d) 241. Also directly related to this petition is the opinion of said Circuit Court relating to the Choctaw & Memphis bonds, a leased line, whose claims for compound interest against this

Debtor are separately treated and found in 155 F. (2d) 889. (See petition for writ of certiorari filed in this Court, October Term—1946, No. 454.)

After the entry of the above interlocutory order of the Circuit Court of Appeals and the rejection of the plan of reorganization by two classes of creditors entitled to vote thereon, including the class of bonds represented by these petitioners, the District Court held a hearing to determine whether said approved plan should be confirmed. Thereafter, and on June 28, 1946, an opinion denying confirmation was filed by the District Court. Said opinion has not been reported but a true copy thereof is found in the additional transcript of record.

The Interstate Commerce Commission has, by order dated July 18, 1946, reopened the proceedings and assigned the same for public hearing for January 7, 1947. A true copy thereof is found in the additional transcript of record.

Jurisdiction

The opinion, order and interlocutory decree of the United States Circuit Court of Appeals for the Seventh Circuit sought to be reviewed, was entered on May 23, 1946 and modified on June 20, 1946, by striking out one paragraph from the opinion (R. 343-356).

On September 18, 1946, said Circuit Court entered an order staying the issuance of its mandate thereon until the disposition by this Court of petitions for writs of certiorari (Add. R. 148).

Jurisdiction of this Court is invoked under the Fifth Amendment of the Constitution of the United States; also under the provisions of Sections 77 and 24(c) of the Bankruptcy Act and Section 240(a) of the Judicial Code.

Jurisdiction of this Court is also invoked by reason of the apparent conflict in the opinion and interlocutory order

of said Circuit Court of May 23, 1946 as modified on June 20, 1946 approving a plan of reorganization for the Debtor and the opinion and intermediate order of the District Court subsequently rendered on June 28, 1946, denying confirmation to said approved plan of reorganization and referring the case back to the Interstate Commerce Commission for modification or the consideration of new plans.

The said interlocutory decree of the Circuit Court of Appeals is likewise in apparent conflict with the order of the Interstate Commerce Commission made and dated July 18, 1946, reopening the case for public hearing for the modification of the present plan and the consideration of new plans of reorganization for the Debtor (Add. R. 143-146).

Appeals from the order of the District Court of June 28, 1946 denying confirmation, taken by respondents directly to the United States Circuit Court of Appeals for the Seventh Circuit, seeking to by-pass the action of the Commission makes it necessary to bring this petition at this time.

Pending the disposition by the Courts of the apparent conflict in status of this proceeding, the Interstate Commerce Commission has upon application of respondents postponed its public hearings on the plan to January 7, 1947.

Statute Involved

The language of the Fifth Amendment to the Constitution of the United States and the pertinent provisions of the Bankruptcy Act, as amended, are found in the Appendix (pp. 29-33, *infra*).

Introductory Statement of Matter Involved

The interest of your petitioners in seeking certiorari springs from the fact that the Convertible Bondholders

Group, full parties to the proceeding in the District Court and before the Interstate Commerce Commission, are the only spokesmen for this $32,228,000 issue of bonds, the fourth largest creditor class and that said bondholders have, by reason of denial of their day in Court on the hearing of objections to the I. C. C. plan of reorganization and the unfair and inequitable treatment in the allocations of cash and securities made to them in the plan of reorganization approved by the Court, been deprived of their property without due process of law.

In order to bring the record up to date, this Court's attention is called to the fact that after hearing of objections duly presented by petitioners, to the confirmation of the approved plan of reorganization, an opinion was rendered and an order was entered by the United States District Court for the Northern District of Illinois, Eastern Division on June 28, 1946, that the plan of reorganization be not confirmed and that the case be referred back to the Interstate Commerce Commission for further proceedings. Consonant with the opinion and order of said Court, one of the trustees for the Debtor appointed by the District Court, the Convertible Bondholders Group, petitioners, and others have submitted proposals and suggested modifications to the approved plan and same are now before the Interstate Commerce Commission and the District Court.

However, since this honorable Court may be of opinion that the previous order and interlocutory decree of the United States Circuit Court of Appeals entered May 23, 1946 (R. 343-355) and as modified June 20, 1946, concludes the District Court from making an order denying confirmation and orders subsequent thereto, petitioners respectfully pray for the issuance of a writ of certiorari directed to said United States Circuit Court of Appeals to send to this Court for review and determination, its said order and decrees of May 23, 1946 as modified June 20, 1946 (R. 343-355).

Statement

The Convertible Gold bonds constitute an issue of $32,228,000 of bonds authorized and approved for sale to the public on May 1, 1930 by the Interstate Commerce Commission (hereinafter called "ICC" or "Commission").

The bonds were accordingly sold to the public after The Chase National Bank of the City of New York (hereinafter referred to as the "Chase Bank") was appointed Trustee for the Convertible bondholders. (Pertinent provisions of the trust Indenture dated May 1, 1930 between the Debtor and the Chase Bank as Trustee is found in the Appendix to Add. R. pp. 1-16.)

In April 1932, the same Chase Bank, heading a group of four other banks, obtained from the Debtor, $15,589,000 in First Mortgage bonds, as collateral for a loan of $8,250,000.

The Chase Bank Group attempted to foreclose its lien on this collateral, but were enjoined from so doing. (See *Chase Nat'l. Bank* v. *Chicago, R. I. & P. R. Co.*, 294 U. S. 648.)

By orders of the District Court made on September 7, 1943 over the opposition of petitioners (District Court Record, p. 4325—Order No. 15B) and successively on September 24, 1943 (District Court Record, p. 4341—Order No. 15C), October 4, 1943 (District Court Record, p. 4347—Order No. 15D) and on October 7, 1943 (District Court Record, p. 4353—Order No. 15E), the injunctive order of said District Court (District Court Record, p. 281—Order No. 15A) as affirmed by this Court in 294 U. S. 648 was revoked and the Chase Bank Group was allowed to sell the collateral held by them.

The Debtor's estate and hence the junior creditors thereby suffered a loss amounting to $13,631,745.15 (Annual Report of Debtor for year 1943. See Appendix to Add. R. 49.).

The foreclosure of the collateral by the Chase Bank Group heretofore enjoined by this Court is directly related to the merits of the plan of reorganization which is the question before this Court, since it reduces the share of the trust estate available to the Convertible Bondholders.

Petitioners' petition to the District Court in 1940, in October 1941, May 1942 and June 1944, on a hearing of these related objections to the plan of reorganization would not be heard by the Court. The objections relating to the Bank loans were ordered stricken out at the outset of the District Court hearing held on October 13, 1941 (Add. R. Appendix, p. 50).

The United States Circuit Court of Appeals similarly held (R. 354) that "a consideration of the cogency of such an argument is not related to the merits of the plan of reorganization", and refused to grant petitioners a hearing thereon.

Petitioners respectfully submit that the rulings of the Courts below were erroneous; that petitioners are entitled to a hearing and determination on the merits of the effect of the Chase Bank Group collateral loans and foreclosure thereof on the treatment accorded to the Convertible Bondholders Group and a determination as to whether the plan should provide more equitable treatment for said bonds as against the Chase Bank Group.

The second aspect of this petition concerns the specific manner in which the claims of the Convertible bondholders were dealt with.

Under the 1940 plan of the ICC (i.e. the plan of October 31, 1940 promulgated and urged by the first and refunding mortgage committee R. 31-161; 247 ICC 533) the Convertible bond issue with a claim of $44,796,920 were allocated 139,654.67 shares of new common stock out of a total proposed issue of 1,512,424.34 shares (See 247 ICC 533) or 4.33 shares of common stock per $1000 of creditor claims

being, in the aggregate, less than 10% of the total common stock proposed to be issued.

After other objections to the 1940 plan were filed and heard before the District Court the plan was remanded to the ICC.

Minor changes were made to the plan by the ICC. In addition, it distributed $38,011,922 in cash to the security holders. The respondents received 99% of the cash and the petitioners received only 1%. Petitioners claim this disposition to be arbitrary and unfair.

Thereupon, the District Court materially altered the plan. It substituted its judgment for that of the Commission and decided "to leave the C. & M. bonds (Choctaw & Memphis) undisturbed, not affected by the plan in any way" (R. 312-313, par. 8). See Petition in this Court, Oct. Term 1946, No. 454.

By thus altering the terms of the plan without ICC approval, the District Court deprived the uncompensated Convertible Bondholders and other unsatisfied junior creditors of the sum of $264,300, which sum is allocated to the C. & M. bondholders.

This material change in the ICC plan made by the Court overcompensated said creditors, not only by the cash, but its improved standing in a reorganized recapitalized company. This change the Court was not authorized to make. The matter was for the Commission to determine (R. 295).

The net effect of the District Court's changes and approval of the respondents' 1940 plan is to give them in addition to the 100% satisfaction of their claims (considering improved securities and curtailed capitalization, etc.), $50,420,522 in cash and new mortgage securities (being the $38,011,922 cash above referred to plus $12,409,600 in first mortgage bonds) plus 90% control of the new authorized common stock of the new company which now includes an

additional $72,000,000 in cash, plus R. F. C. collateral of $41,688,838 in the company treasury.

Since the inception of the plan the assets of the debtor have increased by the sum of $185,241,485. In addition, its annual fixed charges under the proposed plan have decreased by the sum of $625,973. No full consideration of the basic elements of the plan has been had by the Commission since these changes have taken place.

The Convertible Bondholders, therefore, receive no benefit either in new securities or change of status from the improved conditions, and are thus being unjustly deprived of property without due process of law.

The United States District Court for the Northern District of Illinois, Eastern Division, by its order of June 15th, 1945 (R. 309-316) modified (as to the treatment of C. & M. Bonds) and approved the plan. The United States Circuit Court of Appeals for the Seventh Circuit, by its order and decree entered May 23rd, 1946 (R. 355) and as modified June 20th, 1946, affirmed said order of the District Court (Add. R. 93-112).

The Circuit Court, in its opinion, stated, "In so arguing, it seems to us that the debtor overlooks the point that any determination of total capitalization by the Commission is in itself a valuation, which, concededly, is not subject to review" (Add. R. 99).

Although the petitioners brought to the attention of both the District Court and the Circuit Court the fact that the ICC had previously ruled that the return of R. F. C. collateral "would necessitate material modification of the plan", both courts refused to enable the ICC to do so since the return of said collateral.

The District Court has since denied confirmation to the approved plan and said Court and the Interstate Commerce Commission are considering revisions and new proposals, one of which was recently (Nov. 22, 1946) approved by the District Court.

Questions Presented

The review requested herein raises questions of the greatest public and legal importance.

Were petitioners properly denied a hearing on their objection to the plan to the effect that the Chase National Bank, as trustee for the issue of Convertible bonds and the holder of collateral for loans privately extended to the debtor in imminent insolvency, was in the exercise of a dual and conflicting role and that in the exercise of this dual role, the bank violated its position as fiduciary to the Convertible bondholders by retaining or foreclosing collateral belonging to the Debtor?

Certain classes of senior creditors, being fully compensated, and the RFC loans having been paid off pursuant to order of the District Court, November 8, 1944 and collateral amounting to $41,688,838 having been returned to the Debtor estate, is the certified plan of reorganization nevertheless to be approved as fair and equitable when the Interstate Commerce Commission has declared that such payment of RFC loans and return of RFC collateral "would necessitate material modification of the plan" (R. 234)?

Is this plan of reorganization fair and equitable?

Is the action of the District Court in substituting its judgment for that of the Commission and deciding "to leave the C. & M. bonds undisturbed, not affected by the plan in any way" in accordance with Section 77 of the Bankruptcy Act (R. 306)?

Is the affirmance by the U. S. Circuit Court of Appeals of the District Court's approval of the plan proper and should it be permitted to stand in view of its expressed belief that it did not have the authority to reverse the decision of the District Court, which belief is clearly erroneous?

Should the effects of wartime and post-war earnings be considered by the ICC and by the courts in judging the present fairness of the plan?

Reasons Relied on for the Allowance of the Writ

This honorable Court should determine the questions presented by the petitioners since fundamental public policy is involved.

The petitioners should have an opportunity to be heard concerning their objections to the plan in the light of the dual relationship of the Trustee of the Convertible Bonds.

Consideration should be had of the necessity of remanding the plan to the ICC for review after the return of the RFC collateral as per the ruling to that effect by the ICC.

The right of the District Court to modify the plan materially without receiving the prior approval of the ICC should be reviewed.

The authority of the Circuit Court to review obsolete valuations of the ICC in the light of substantial improvements accruing since the inception of the plan should be defined by this Court.

The law should be clarified by a ruling of this court that a plan may be denied approval by any court if it has, through obsolescence, become unfair to any class of creditors.

Conclusion

The Convertible Bondholders Group respectfully submits that the decision of the U. S. Circuit Court of Appeals for the Seventh Circuit is erroneous, that the questions involved are constitutional questions and are of general public importance, and that it is in the public interest to have those questions answered as soon as practicable by an authoritative decision of this Court.

WHEREFORE, the petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this honorable Court, directed to the United States Circuit Court of Appeals for the Seventh Circuit, directing that Court to certify and send to this Court for its review and determination on a day certain to be named therein, a transcript of the record and proceedings herein; that the decree of said Court be reviewed insofar as the method and treatment of the Convertible Bondholders' and junior creditors' claims generally are concerned and insofar as it approves the plan of reorganization, to the end that the judgment herein of said Circuit Court of Appeals be reversed; and that your petitioners may have such other and further relief in the premises as to this Court may seem just and proper.

Dated, New York, N. Y., December 13, 1946.

HARRY KIRSHBAUM,
MICHAEL GESAS,
Counsel for Petitioners.

IN THE

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OCTOBER TERM, 1946.

No. .....

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IN THE MATTER

of

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Debtor.

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Petitioners,

v.

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Respondents.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Opinions Below

The opinion of the Circuit Court of Appeals for the Seventh Circuit (R. 343-355) is reported in 157 F. (2d) 241. The opinion of the District Court (R. 301-308) has

not been reported. Directly related to the approved plan of reorganization in this proceeding and hence to this petition for writ of certiorari is the opinion and decision of the said Circuit Court in the *Choctaw & Memphis* case (No. 454, petition for writ of certiorari, October Term, 1946) reversing the opinion of the District Court. This companion opinion is reported in 155 F. (2d) 889. The opinion of the District Court is not reported but will be found in Cause No. 454 before this Court for the October 1946 Term under the title "Joseph B. Fleming and Aaron Colnon, Trustees, etc., Petitioners versus John C. Traphagen, James E. Gowen, et al., etc., Respondents."

Jurisdiction

On June 20, 1946, the United States Circuit Court of Appeals for the Seventh Circuit entered an order affirming the interlocutory order of the District Court approving the plan of reorganization for the Debtor.

Thereafter, and on June 28, 1946, the District Court having jurisdiction denied confirmation to said approved plan and referred the case back to the Interstate Commerce Commission for modification and for the consideration of new plans.

On July 18, 1946, the Interstate Commerce Commission made an order reopening the case for public hearing for the modification of the present plan and the consideration of new plans of reorganization for the Debtor. Appeals from the order of the District Court of June 28, 1946 denying confirmation have been filed by several parties in the United States Circuit Court of Appeals, Seventh Circuit from July 26 to August 7, 1946.

In order to avoid multiplicity of and confusing litigation, petitioners herein made application to the said Circuit Court for rehearing and reargument of the order of affirmance and for modification or recall of its inter-

locutory opinion and order of June 20, 1946, setting forth the subsequent opinions and orders of the District Court denying confirmation of the plan and of the Interstate Commerce Commission reopening the case and assigning the same for public hearing.

On September 18, 1946, the Circuit Court entered an order on said application denying petitioners' motion for reargument and recall of its opinion but granting a stay of mandate until the disposition by this Court of petitions for writ of certiorari (See Additional Transcript of Record pp. 114-149).

Jurisdiction is, therefore, lodged in this Court to hear and determine this petition for writ of certiorari and the appeal from the original judgment entered in the Circuit Court.

Gypsy Oil Co. v. *Escoe,* 275 U. S. 498;
Pfister v. *Northern Illinois Finance Corp'n.,* 317 U. S. 144 at page 149;
Market Street R'y. v. *Railroad Commission of California,* 324 U. S. 548.

Petitioners have kept this honorable Court advised of current applications in this proceeding brought by petitioners before the United States Circuit of Appeals, the granting of which would obviate recourse to this honorable Court. The motion brought before the Circuit Court for rehearing and recall of its opinion was as this Court is aware, based on substance and was not merely for the purpose of extending time to bring this petition for certiorari.

Hence the time for appeal to this honorable Court has not expired.

Leishman v. *Associated Electric Co.,* 318 U. S. 203, 205-6;
Pfister v. *Northern Illinois Finance Corp'n.* (*supra*), 317 U. S. 144;

Zimmern v. *U. S.*, 298 U. S. 167;
Section 8(a) of the Act of February 13, 1925 to amend the Judicial Code, Chap. 229, 43 Stat. 936.

The time for filing a petition for writ of certiorari is computed from the date of entry of the order of the Circuit Court dated September 18, 1946, staying the issuance of the mandate until disposition of this petition on the merits.

Commissioner of Int. Revenue v. *Bedford's Estate*, 325 U. S. 283, 285, 286.

A statement of the constitutional, statutory and other grounds on which the jurisdiction of this Court is invoked is given in the petition (pp. 3-4) and to avoid duplication, is not repeated here.

Statement of Case

A statement of the case is set forth in the petition under the headings "Introductory Statement of Matter Involved" and "Statement" and to avoid duplication, is not repeated.

Specification of Errors

The Circuit Court of Appeals erred:

1. In ruling that the Chase National Bank, in the dual and conflicting role of trustee for the Convertible bonds and as holder of collateral for loans privately extended to the Debtor without knowledge or consent of the Convertible Bondholders was not violating its position as fiduciary and not prejudicial to the Convertible Bondholders and the treatment accorded to them in the plan of reorganization approved by the Court.

2. In ruling that the District Court properly refused to hear pertinent objections to the plan of reorganization duly filed by petitioners and in denying petitioners a hearing on related objections to the plan. (Add. R. Appendix p. 50).

3. In holding that the plan of reorganization is fair and equitable and compatible with the public interest and that it complies with the requirements of subsections (b) and (e) of Section 77 of the Bankruptcy Act, as amended.

4. In holding that the plan of reorganization affords due recognition to the rights of the Convertible Bondholders and that the same does not discriminate unfairly in favor of holders of preferred securities.

5. In holding that the R.F.C. collateral returned to the trust estate should remain undistributed, despite the ruling of the Interstate Commerce Commission that the payment of the R.F.C. claims "would necessitate material modification in the plan" (257 ICC 265, 272), and despite the fact that the Convertible Bondholders are virtually excluded from participation in the plan of reorganization.

6. In approving as a valid post-war plan an outmoded reorganization for the debtor, a plan in fact, formulated and adopted prior to the commencement of the war (1937-1940) and based on depressed earnings, etc. of that period.

7. In approving as valid, a plan of reorganization for the debtor which was altered in several material respects by the District Court without resubmission to or re-examination by the Interstate Commerce Commission.

8. In incorrectly denying to itself the authority to review the obsolete valuations of the ICC in the light of substantial improvements in the financial condition of the Debtor.

9. In approving the distribution of $12,409,600 in new first mortgage bonds and $38,011,922 in cash to the senior creditors on an arbitrary basis in direct variance with the provisions of the approved plan and without regard to proper legal and equitable standards.

10. In denying petitioners' application for reconsideration, reargument and recall of its opinion and order of May 23, 1946 and June 20 1946 since the District Court in the due exercise of its judicial powers given pursuant to Sec. 77 of the Bankruptcy Act, as amended, properly refused to confirm the plan of reorganization for the Debtor and referred the case to the Interstate Commerce Commission for re-examination to afford the parties their day in Court and said Interstate Commerce Commission has ordered the case re-opened and assigned for public hearing for modification of or the consideration of new plans of reorganization.

11. Upon such other errors as may appear to this Court not assigned or specified herein.

Summary of Argument

In the interest of directness and conciseness, petitioners set forth briefly, the propositions of law relied on to support the foregoing petition (Rules 27 and 38 of Rules of Supreme Court of United States).

I.

The plan of reorganization approved countenances illegal preference treatment given to the Chase Bank Group for first mortgage collateral privately obtained from the Debtor without consent of the Convertible Bondholders by allocating to them 262% of the amount of their claim in new choice securities at the direct expense of the Con-

vertible Bondholders who remain virtually excluded from participation in the plan of reorganization.

Said plan which thus rewards such conduct of a trustee for bondholders by permitting it to retain or foreclose said collateral in lieu of payment as was done with the R.F.C. loans, or other equitable treatment of its claim is a fraud upon the bondholders the *cestuis que trusts* and is unjust, unfair, inequitable and incompatible with the public interest.

> Section 60 of the Bankruptcy Act, as amended;
> *Buffum* v. *Barceloux Co.*, 289 U. S. 227 at page 236.

The Chase Bank Group should be held to account as a trustee *ex maleficio* for its conduct and the value of the collateral which it improperly acquired and then retained or conveyed to others.

> *Buffum* v. *Barceloux Co.*, 289 U. S. 227, 236;
> *U. S.* v. *Dunn*, 268 U. S. 121;
> *Jackson* v. *Smith*, 254 U. S. 586, 588;
> *Magruder* v. *Drury*, 235 U. S. 106;
> *Meinhard* v. *Salmon*, 249 N. Y. 458, 164 N. E. 545, per Cardozo, J.

A plan of reorganization which approves, accepts and recognizes this wrongful discrimination against the Convertible Bondholders is invalid.

II.

The District Court and Circuit Court denial to petitioners of a hearing on objections under Section 77 of the Bankruptcy Act, as amended, relating to the Chase Bank Group's unlawful possession of the Debtor's collateral and the preference treatment accorded said Group under

the approved plan of reorganization which directly and adversely affected the Convertible Bondholders' interests and allocation of securities thereunder, was unconstitutional and a deprivation of their property without just compensation.

Fifth Amendment to the Constitution of the United States;
In re Central R. Co. of New Jersey (C.C.A. 1943) 136 F. (2d) 633, certiorari denied 320 U. S. 805;
Fierman v. *Seward Nat'l. Bank of N. Y.*, 61 F. (2d) 952, certiorari denied 288 U. S. 613;
In re Times Square Auto Supply Co., 47 F. (2d) 240 reversing 43 F. (2d) 661, certiorari denied 283 U. S. 856.

III.

The District Court did not have the right to modify the plan without the prior approval of the Commission. Section 77(d) of the Bankruptcy Act provides, in part:

> "No plan shall be approved or confirmed by the judge in any proceeding under this section unless the plan shall first have been approved by the Commission and certified to the court."

Section 77(e) defines the rights and prerogatives of the Court after certification to it of a plan by the Commission. That section gives the court the right to approve the plan, disapprove and dismiss the proceedings, or disapprove and refer the proceedings back to the Commission for further action. Nowhere is the court given the right to modify the plan.

It is respectfully submitted that the plan *as it now exists* has not been approved by the Commission nor certified by it to the court. The last report of the Commission is dated May 1, 1944. On November 8, 1944 the court

ordered the claim of the R. F. C. paid. As a result thereof collateral securities valued at $40,310,722 were returned to the debtor. On June 15, 1945, the court ordered that the Choctaw & Memphis Bonds shall remain undisturbed in the reorganization. (See Exhibit A to the plan.)

Not only must the Commission pass upon these modifications of the plan under the above quoted portion of Section 77(d), but it should have an opportunity to appraise the effect of these changes upon the remainder of the plan.

This is particularly true in the light of the Commission's express statement that payment of the R. F. C. loan "would necessitate material modification of the plan" (R. 234).

The Circuit Court itself recognized the correctness of this principle, despite the fact that it did not act in accordance therewith. The court said, in its opinion (R. 345):

> "The Court must approve or disapprove the plan in its entirety. It alone cannot correct the plan but it may suggest improvements to the Commission."

To the same effect is *Ecker* v. *Western Pacific Railway Co.*, 318 U. S. 448, wherein the Supreme Court said, at page 474:

> "Thus limited the district court acts concerning the plans only upon the issues specifically delegated by sub-section (e). As to these, its powers are negative. It may veto the plan in its entirety but may improve it only by suggestion."

The Circuit Court's affirmance of the modification of the plan by the District Court was reversible error.

IV.

The Circuit Court has the right to review the plan in the light of improvements subsequent to the inception of the plan. Its failure to recognize its authority so to do constitutes reversible error.

Petitioners concede that they cannot in this appeal attack the validity of the Commission's valuation as of the time of its deliberations concerning such valuations. No such attack is here made. Petitioners further concede that abnormal wartime earnings should not properly be used as a guide to future earnings.

The petitioners do insist, however, that the authority of the courts, both the District Court and the Circuit Court, extends to:

1. A review of the *method* of evaluation adopted by the Commission; and

2. A review of the *effect* of wartime income, actually earned, upon the capital structure of the debtor.

These two points may be considered in order.

1. *The method of valuation.*

By its October 31, 1940 report the Commission valued the property of the debtor at $351,000,000 (R. 142). By its July 31, 1941 report the Commission increased its valuation to $368,127,410 (R. 168). The petitioners accept as valid for purposes of this petition these two valuations as of the date of the respective reports.

However, in the report dated January 3, 1944, the Commission reduced the valuation to $356,117,327 (R. 245). The reason for the reduction is given in the report of May 1, 1944 (R. 250). The report reads:

> "From the foregoing it is clear that the decrease of $12,010,083 is the net result from the reduction of

> $13,034,916 in the equipment obligations during the period January 1, 1942, the former effective date of the plan, to January 1, 1944, the new effective date of the plan and the increase of $1,024,833 in the new common stock provided for in the plan. There is no decrease in the amount of the various other classes of securities comprising the total capitalization. As in other reorganization proceedings, the plan in this proceeding contemplates leaving equipment obligations of the debtor undisturbed. The capitalization of $356,117,327, includes equipment obligations outstanding as of January 1, 1942. While the reduction in the amount of equipment obligations reduced somewhat the fixed annual cash requirements of the reorganized company, this fact was recognized by us in the approval of an increase of $1,024,833 in the amount of Common Stock provided for in the supplemental report of January 3, 1944. We also recognize that the amount of equipment obligations of a railroad is subject to fluctuation upward as well as downward, and in our opinion, we would not be warranted in increasing the amounts of the various other classes of securities comprising the approved capitalization to any greater extent than was done."

Hence it may be seen that the reduction in valuation of the debtor's property was made on the basis of a *reduction* in outstanding equipment obligations. It is obvious that the reduction in outstanding obligations actually reflects an *increase* in the value of the debtor's property. A decrease in valuation was clearly unwarranted.

This Court, in *Ecker* v. *Western Pacific Railway Corp.*, 318 U. S. 448, said, at page 474:

> "While by the terms of the statute the valuation of the property is left to the Commission, without participation by the Court, this valuation must be made

in accordance with the direction of the statute and as to that valuation is subject to judicial review."

It is submitted that the court's authority to review the method of valuation extends to a review of the method of re-valuation, and that re-valuation downward based upon a decrease in corporate liabilities is error in method sufficient to warrant rejection by the court.

2. *The effect of wartime earnings.*

In *Institutional Investors* v. *Chicago, Milwaukee, St. Paul and Pacific Railway Co.*, 318 U. S. 523, this Court said, at page 543:

> "We cannot assume that the figures of war earnings could serve as a reliable criterion for that 'indefinite future'. As some of the bondholders point out, the bulge of war earnings per se is unreliable for use as a norm unless history is to be ignored; and numerous other considerations, present here as in former periods, make them suspect as a standard for any reasonably likely future normal year."

The petitioners do not urge such use of wartime earnings. However, it cannot be denied that huge wartime profits were earned. These earnings went into the assets of the debtor. With these earnings debts were paid, improvements were made, cash reserves were built up, and there was a general strengthening of the financial condition of the debtor. The extent of the changes made possible by these wartime earnings will be later discussed.

No authoritative decision has yet been made as to whether such changes, actually accomplished since the last properly considered valuation by the Commission, may be the basis for the refusal of the courts to approve a plan. The expressed belief of the Circuit Court that it could not now review the Commission's valuations, made obsolete by the *effects* of wartime earnings was reversible error.

V.

The effects of wartime earnings on the capital structure of the debtor were sufficiently substantial to warrant the rejection of the plan. Two factors affect the starting point of a consideration of this point. First, it should be remembered that the *last* properly considered valuation by the Commission was reflected in its report of July 31, 1941. Second, the District Court, in its opinion rendered upon its refusal to confirm the plan, stated:

> "In the present case we have a plan that except for slight modifications was prepared by the Commission in 1940 and rests on earnings, etc., going back to 1937 and even beyond." (Add. R. 138.)

The facts that evidence the effects of the wartime earnings are as follows:

That the Trustees for the debtor estate made total net capital expenditures from Jan. 1, 1940 to Apr. 30, 1946 of	$37,246,965.49
That the total net decrease in outstanding debt from Apr. 30, 1940 to Apr. 30, 1946 amounted to	$25,411,598.97
That the total amount of cash or cash equivalents in the hands of the debtor as of Apr. 1, 1946 is	82,272,199.08
That R. F. C. collateral returned to the debtor is valued at	40,310,722.02
That the total, actual increase in value of the debtor's property in Apr. 1946 over Jan. 1940 amounts to	$185,241,485.56.

These facts are not a part of the record in the proceeding before the District Court for approval of the plan. However, they are official records of the debtor, prepared by the auditor of the debtor, and were introduced in evidence before the District Court in the proceeding for confirmation. (See record on appeal to Circuit Court of those proceedings.)

In addition to the above factors which constitute direct items of increased value of the debtor estate, a substantial reduction in fixed annual charges of the company has been effected since the inception of the plan. These reductions resulted from changes in the plan made since the last consideration of the plan by the Commission. They are broken down as follows:

R.F.C. Securities:	Amount	Int. Rate	Fixed Charges eliminated
Collateral note	$2,500,000.	2½%-1½%	$ 62,500.00
First Mtg. Bonds ..	4,070,874.	4%	162,834.96
Gen'l Mtg. Bonds..	5,992,850.	4%	259,678.25
Choctaw & Memphis Securities:			
New C. & M. Bonds	$3,524,000.	4%	$140,960.00
Total annual reduction of fixed charges: ...			*$625,973.21*

The record shows that the amount of fixed interest charges was basic in the composition of the plan. The Commission stated:

> "It is our opinion that, in order to provide a margin for minimum additions and betterments, the fixed-interest charges of the reorganized company should not exceed $2,400,000" (R. 142).

A comparison between the maximum amount of fixed interest charges permitted under the plan and the amount of fixed interest charges reduced since the inception of the plan clearly indicates a need for complete revision of the plan.

VI.

Substantial justice would result from a reversal of the decision of the Circuit Court, and a remanding of the plan to the Commission for further consideration.

After approval of the plan, it was submitted to the security holders for their approval. Two classes of security holders rejected the plan by overwhelming majorities. Thereupon the plan was submitted to the District Court for confirmation. The District Court refused to confirm the plan, and, by order dated July 22, 1946, referred the plan back to the Commission for reconsideration. (Add. R. 140-142.) Appeals to the Circuit Court from this order are now pending.

The Court found that the plan does not make adequate provision for fair and equitable treatment of the Convertible Bondholders, and that it does not conform to the requirements of subsection (e) of section 77 of the Bankruptcy Act.

If the plan is unfair, and does not conform to the requirements of the act, it should not be put into effect. Whether the remanding should occur upon proceedings to approve or upon proceedings to confirm properly depends upon whether the changed conditions making such remanding proper occurred between inception of the plan and the proceedings to approve, or between approval of the plan and proceedings to confirm. (*R. F. C.* v. *Denver & R. G. W. R. Co.*, 66 Sup. Ct. 1282.)

However, whether the remanding occurs in one proceeding or the other, the result is the same. The plan will be reconsidered by the Commission and, presumably, a fair and equitable plan will result from its new deliberations. A reversal of the decision herein appealed from will eliminate further time and money consuming litigation in connection with the proceedings to confirm.

It is not the intention of the petitioners to suggest to this honorable Court that the confirmation proceedings are in any way binding in the proceedings to approve, nor that a short cut be taken even in the interests of justice. This last point would never have been written were it not for the sincere belief that the remainder of the brief includes cogent, legal justification for a reversal; and the added consideration that the difficulty of determining exactly when the changed conditions occurred should not, in justice, react to the detriment of the petitioners.

Conclusion

Petitioners respectfully submit that the decision of the Circuit Court of Appeals for the Seventh Circuit is erroneous; that the questions involved are constitutional questions and are of general importance in the administration of the Bankruptcy Act and that it is in the public interest to have the order of the said Circuit Court reviewed and determined by this Court and that the order and mandate of the Circuit Court be stayed meantime until the final hearing and determination by the Interstate Commerce Commission and the Courts below of a new or revised *confirmed* plan of reorganization for the Debtor.

Dated, December 13, 1946.

Respectfully submitted,

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APPENDIX "A"

FIFTH AMENDMENT

TO THE

CONSTITUTION OF THE UNITED STATES.

No person shall be held to answer for a capital, or otherwise infamous crime unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be *deprived of life, liberty, or property, without due process of law;* nor shall private property be taken for public use, without just compensation. (Emphasis ours.)

APPENDIX "B"

The Bankruptcy Act, as amended:

Sec. 24(c). The Supreme Court of the United States is hereby vested with jurdisdiction to review judgments, decrees, and orders of the Circuit Court of Appeals of the United States and the United States Circuit Court of Appeals for the District of Columbia in proceedings under this title in accordance with the provisions of the laws of the United States now in force or such as may hereafter be enacted. (11 U.S.C.A. section 47(c).)

Sec. 77(b). A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; (2) may include provisions modifying or altering the rights of stock-

holders generally, or of any class of them, either through the issuance of new securities of any character, or otherwise; (3) may include, for the purpose of preserving such interests of creditors and stockholders as are now otherwise provided for, provisions for the issuance to any such creditor or stockholder of options or warrants to receive, or to subscribe for, securities of the reorganized company in such amounts and upon such terms and conditions as may be set forth in the plan; (4) shall provide for fixed charges (including fixed interest on funded debt, interest on unfunded debt, amortization of discount on funded debt, and rent for leased railroads) in such an amount that, after due consideration of the probable prospective earnings of the property in light of its earnings, experience, and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof; (5) shall provide adequate means for the execution of the plan, which may include the transfer of any interest in or control of all or any part of the property of the debtor to another corporation or corporations, the merger or consolidation of the debtor with another corporation or corporations, the retention of all or any part of the property by the debtor, the sale of all or any part of the property of the debtor either subject to or free from any lien at not less than a fair upset price, the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein, the satisfaction or modification of any liens, indentures, or other similar interests, the curing or waiver of defaults, the extension of maturity dates of outstanding securities, the reduction in principal and/or rate of interest and alteration of other terms of such securities, or in satisfaction of claims or rights or for other appropriate purposes; and may deal with all or any part of the property of the debtor; may reject contracts of the debtor which are executory in whole or in part, including unexpired leases; and may include any other appropriate provisions not inconsistent with this section. (11 U.S.C.A. section 205(b).)

Sec. 77(d). The debtor, after a petition is filed as provided in subsection (a) of this section, shall file a plan of reorganization within six months of the entry of the order by the judge approving the petition as properly filed, or if heretofore approved, then within six months of August 27, 1935, and not thereafter unless such time is extended by the judge from time to time for cause shown, no single extension at any one time to be for more than six months. Such plan shall also be filed with the Commission at the same time. Such plans may likewise be filed at any time before, or with the consent of the Commission during, the hearings hereinafter provided for, by the trustee or trustees, or by or on behalf of the creditors being not less than 10 per centum in amount of any class of creditors, or by or on behalf of any class of stockholders being not less than 10 per centum in amount of any such class, or with the consent of the Commission by any party in interest. After the filing of such a plan, the Commission, unless such plan shall be considered by it to be prima facie impracticable, shall, after due notice to all stockholders and creditors given in such manner as it shall determine, hold public hearings, at which opportunity shall be given to any interested party to be heard, and following which the Commission shall render a report and order in which it shall approve a plan, which may be different from any which has been proposed, that will in its opinion meet with the requirements of subsections (b) and (e) of this section, and will be comparable with the public interest; or it shall render a report and order in which it shall refuse to approve any plan. In such report the Commission shall state fully the reasons for its conclusions.

The Commission may thereafter, upon petition for good cause shown filed within sixty days of the date of its order, and upon further hearings if the Commission shall deem necessary, in a supplemental report and order modify any plan which it has approved, stating the reasons for such modification. The Commission, if it approves a plan, shall

thereupon certify the plan to the court together with a transcript of the proceedings before it and a copy of the report and order approving the plan. No plan shall be approved or confirmed by the judge in any proceeding under this section unless the plan shall first have been approved by the Commission and certified to the court. (11 U.S.C.A. section 205(d).)

Sec. 77(e). Upon the certification of a plan by the Commission to the court, the court shall give notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made under or to be

made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such payment, and the judge is hereby given power to approve the same.

* * * * *

If it shall be necessary to determine the value of any property under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts. (11 U.S.C.A. section 205(e).)